Belgium Rewrites Antiavoidance Rule

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Belgium has passed a law that modifies its antiavoidance rule for VAT matters. The Belgian Parliament adopted a general antiavoidance rule for VAT at the end of 2005. A Program Law dated July 20 (published July 28), completely rewrites the VAT antiavoidance rule in light of recent European Court of Justice judgments.

Statutory General Antiavoidance Rule

In 1993 Belgium introduced a general antiavoidance rule in the Income Tax Code (article 344, section 1 ITC 1992), the Inheritance Tax Code (article 106 IHTC), and the Registration Tax Code (article 18, Reg.TC). The statutory rule allows the tax authorities to disregard the legal classification given to a specific transaction if they can prove that parties have chosen that classification instead of another for the sole purpose of avoiding income tax. In that case the tax authorities can recharacterize the transaction to assess the tax on a less beneficial basis. The taxpayer is then left with the burden of proving that the chosen classification meets lawful financial or economic requirements.

The tax authorities can also use the general antiavoidance rule when they prove that parties have split up a single legal transaction into separate legal transactions, realizing a same transaction for income tax reasons only. It allows the tax authorities to disregard the separate steps and treat them as one single operation.

The VAT Code did not have an antiavoidance rule until 2005, when the government proposed that a similar text be introduced in article 59 of the VAT Code. However, on November 4, 2005, the Supreme Court delivered a serious blow to the statutory general antiavoidance rule in the Income Tax Code. (For prior coverage, see *Tax Notes Int'l*, Jan. 16, 2006, p. 141, *2005 WTD 245-5*, or *Doc 2005-25677* [PDF].) The Supreme Court confirmed that the characterization proposed by the tax authorities must have the same legal consequences as the transaction that the taxpayer presented.

Moreover, in a preliminary report on the proposed legislation, the Council of State suggested that Parliament wait for the decision of the ECJ in *Halifax plc* (C-255/02). Parliament ignored that advice and adopted article 128 of the *Loi Programme* of December 27, 2005.

In fact, before its decision in *Halifax*, the ECJ rendered another important decision in *Optigen* (C-354/03). And in July, the ECJ confirmed the judgments in *Optigen* and *Halifax* in joined cases C-439/04 and C-440/04, which involved Belgian taxpayers. (For the ECJ judgment in joined cases *Axel Kittel v. Belgium* (C-439/04) and *Belgium v. Recolta Recycling S.P.R.L* (C-440/04), see *2006 WTD 136-6* or *Doc 2006-13451* [PDF].)

In those cases, bona fide VAT payers had unwittingly become involved in a so-called VAT fraud carousel: a chain of transactions in which one of the operators purchases goods without paying VAT (usually following an intracommunity supply), collects the VAT on its sales, and disappears without paying the VAT to the tax authorities. CPUs and other high value high-tech products are often used in VAT fraud cases.

In Belgium, the VAT authorities try to prevent VAT carousels with reverse charge systems and, in the absence of an antiavoidance rule, to fight them on the basis of the civil law principle that any transaction must have a "lawful basis." The Supreme Court has decided that a transaction that seeks to harm the rights of the tax authorities does not have a lawful basis and as such is null and void, even if the other party to the transaction was not aware of that. (See Cass., Oct. 12, 2000, *Pasicrisie*, 2000, I-1531.) Because the supply is deemed fictitious under domestic law, the taxpayer can be denied the VAT refund. Even if the taxpayer himself acted in good faith, the VAT deduction can be disallowed in case of fraud.

European Case Law

In joined cases *Optigen Ltd* (C-354/03), *Fulcrum Electronics Ltd* (C-355/03), and *Bond House Systems Ltd* (C-484/03), the U.K. tax authorities argued that Optigen and Fulcrum received no supplies used or to be used for VAT purposes, so that the VAT those companies had paid to the defaulting trader for those purchases was not input tax within the meaning of the Value Added Tax Act 1994. And because the relevant sales were not supplies made in the course of a business, they could not allow a refund. Finally, the purchases and the sales, judged objectively, were devoid of economic substance and were not part of any economic activity.

Optigen

In *Optigen* the ECJ stressed that the concepts of "supply of goods," "taxable person," "economic activities," and "taxable person acting as such" as defined in the Sixth VAT Directive are all objective in nature and apply without regard to the purpose or results of the transactions concerned.

Consequently, each transaction must be regarded on its own merits, irrespective of earlier or subsequent events. That means that transactions that are not vitiated by VAT fraud constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of articles 2(1), 4, and 5(1) of the Sixth Directive. Only the objective criteria on which the definitions are based can be taken into account, regardless of the intention of a trader other than the taxable person involved and/or the possible fraudulent nature of another transaction in the same chain of supply, before or after the transaction carried out by a VAT payer, if that VAT payer had no knowledge and no means of knowledge.

Moreover, the right to deduct VAT (under article 17 et seq. of the Sixth VAT Directive) is an integral part of the VAT scheme, and as a matter of principle may not be limited. That means that a VAT payer's right to deduct input VAT cannot be affected by the fact that in the chain of supply of which those transactions are part, another prior or subsequent transaction is vitiated by VAT fraud, if the VAT payer did not know or did not have any means of knowing. The ECJ clarified that the fact that VAT on a prior or subsequent sale of the goods to the end user has not been paid is irrelevant to the right of the taxable person to deduct input VAT. The ECJ has consistently held that VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components.

The ECJ admitted that this position undermines antiavoidance legislation that requires the tax authorities to take account of the intention of another trader and/or the possible fraudulent nature of another transaction in the same chain of supply (whether that is before or after the transaction carried out by that taxable person), of which that taxable person had no knowledge and no means of

knowledge. Such antiavoidance rule would a fortiori be contrary to the objectives of the common system of VAT of ensuring legal certainty and facilitating application of VAT by having regard, except in exceptional cases, to the objective character of the transaction in question.

Axel Kittel

The Belgian Supreme Court referred to the ECJ a reference for a preliminary ruling to confirm whether the VAT authorities can deny a taxpayer the right to deduct VAT based on a domestic rule that renders the transaction null and void.

In general terms, the ECJ confirmed its judgment in *Optigen* in a situation in which the fraud was committed by the taxpayer's direct contract party, but only if the taxpayer person did not and could not know that. In fact, it denies the Belgian VAT authorities the right to rely on the theory of the unlawful basis of the contract attributable to the seller, to deny a taxpayer the right to deduct the input VAT.

However, the ECJ confirmed that preventing tax evasion, avoidance, and abuse is an objective recognized and encouraged by the Sixth Directive and that Community law cannot be relied on for abusive or fraudulent ends. If the taxpayer knew or should have known that he was taking part in a transaction connected with fraudulent evasion of VAT, he must be regarded as a participant in that fraud. It is, therefore, for the domestic court to use objective factors in examining whether the taxpayer had or should have had such knowledge.

Halifax

The situation in *Halifax* and *Huddersfield* was different. (For the ECJ judgment in *University of Huddersfield Higher Education Corporation* (C-223/03), see *2006 WTD 35-21* or *Doc 2006-3358* [PDF].) In those cases the taxpayer himself had chosen a transaction to minimize his tax liability or to accrue a tax advantage.

The ECJ confirmed and clarified this in its judgment in *Halifax*. Transactions constitute supplies of goods or services and an economic activity within the meaning of the Sixth Directive if they satisfy the objective criteria on which those concepts are based. The ECJ, however, clarified that this was the case "even if they are carried out with the sole aim of obtaining a tax advantage, without any other economic objective." While the intention is irrelevant for a supply of goods or services, it is even more for the right to deduction of VAT.

While confirming that taxpayers may choose to structure their business so as to limit their tax liability, the ECJ held that the application of European Community legislation cannot be extended to cover abusive practices by economic operators. The Sixth Directive must be interpreted as precluding any right of a taxable person to deduct input VAT when the transactions from which that right derives constitute an abusive practice. The ECJ distinguished two criteria: The transactions concerned result in the accrual of a tax advantage, the grant of which would be contrary to the purpose of those provisions, even though formally parties apply the statutory conditions.

Regarding the accrual of a tax advantage, the ECJ noted that the common system of VAT ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, if they are themselves subject in principle to VAT. The ECJ pointed out that to determine the extent of a taxpayer's entitlement to deduct input VAT, there must be a direct and immediate link between the input transaction and a particular output transaction or transactions giving rise to entitlement to deduct. It would, therefore, be contrary to the principle of fiscal neutrality and the purpose of the VAT rules to allow taxable persons to deduct all input VAT even though they would not be entitled to the deduction in the context of their normal commercial operations.

In other words, when taxable persons arrange their transactions in a way that they create a tax advantage that is not meant as such in the VAT rules (with its exemptions and its limitations of deductions), they are infringing the fundamental principal of the fiscal neutrality. It is apparent from several objective factors that the essential design of the transactions concerned is to obtain a tax advantage.

While the ECJ leaves it to the national court to determine the substance and significance of the transactions, it suggests that the court may take into account the purely artificial nature of those transactions, including the legal, economic, and personal links between the operators involved in the tax reduction scheme.

When a national court does find an abusive practice, it must redefine the transactions involved to reestablish the situation that would have prevailed in the absence of the transactions constituting that abusive practice. The tax authorities can claim repayment of the input VAT deducted abusively, after deduction of any tax charged on an output transaction. Similarly, a taxable person who, in the absence of transactions constituting an abusive practice, would have benefited from the first transaction that does not constitute an abusive practice, may deduct the VAT on that input transaction in accordance with the deduction rules of the Sixth Directive.

New Antiavoidance Rule

The Belgian tax authorities realized that they could not retain the antiavoidance rule in article 59, section 3 in light of ECJ case law. The antiavoidance rule relied on an examination of the intention of the taxpayer, which the ECJ had decided was contrary to the objectives of the VAT system. Moreover, in *Halifax*, the ECJ emphasized that for there to be an abusive practice, obtaining the tax advantage must be an essential aim of the transactions.

That is why the government has tried another approach by including a definition of abusive practices in article 1 of the VAT Code:

> For the application of this [VAT] Code, there is an abusive practice where the transactions carried out result in obtaining a tax advantage the grant of which is contrary to the purpose of this Code and the royal decrees implementing the Code, and the essential aim of the transactions concerned is to obtain this advantage. [New article 1, section 10 VAT Code.]

And when there is an abusive practice, new article 79, section 2 provides that the taxpayer will have to reimburse the input VAT it has deducted.

The new provision is clearly based on ECJ case law. However, while that case law is currently limited to the right to deduct input VAT, the Belgian government wants to apply the same principles to other abusive practices. The government has mentioned that this could be the case when a taxpayer has

issued an invoice for services rendered to a foreign permanent establishment (without VAT) instead of the Belgian head office, in which case Belgian VAT would be due. There is no provision that explains how the situation has to be redressed in that situation.

However, a new provision has been included to make a taxpayer jointly and severally liable with the person who is liable, for payment of that tax in cases of tax avoidance. That would be the case if, at the time of payment, the taxpayer knew or should have known that somewhere in the chain of transactions the VAT has not been paid or would not be paid (new article 51 *bis*, section 4 of the VAT Code).

Although that provision is extensive, it will have to be read in light of the ECJ case law regarding *Federation of Technological Industries*. (For the ECJ judgment in *Federation of Technological Industries* (C-384/04), see *2006 WTD 92-6* or *Doc 2006-9211* [PDF].) In that judgment, the ECJ decided that article 21, section 3 of the Sixth VAT Directive allows such legislation if the taxpayer knew or had reasonable grounds to suspect that some or all of the VAT payable for that supply, or for any previous or subsequent supply, would go unpaid.

Although the government announced that it did not expect more than a reasonable level of care from the taxpayer, it said that the taxpayer has to be particularly vigilant if:

- the asking price is abnormally low;
- the quantities of products are abnormally high;
- the amounts involved are abnormally high in view of the trader's estate;
- the products are not the sort of products the trader usually trades in; or
- if there are personal, economic, or legal links between contract parties.

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